

Lessons Learned from IRS Free Filers: Capturing Young Taxpayers for a Lifetime of Electronic Filing



David C. Cico and Courtney L. Howard Olson
IRS Wage & Investment Research and Analysis
IRS Research Conference – June 12, 2008



Internal Revenue Service

Research Objectives

In this study, the researchers strive to accomplish two main objectives:

1. determine whether the Free File program acts as a gateway to electronic filing.
2. identify market segments with the greatest potential for increasing participation in the Free File program and consequently increasing the number of electronic returns filed.

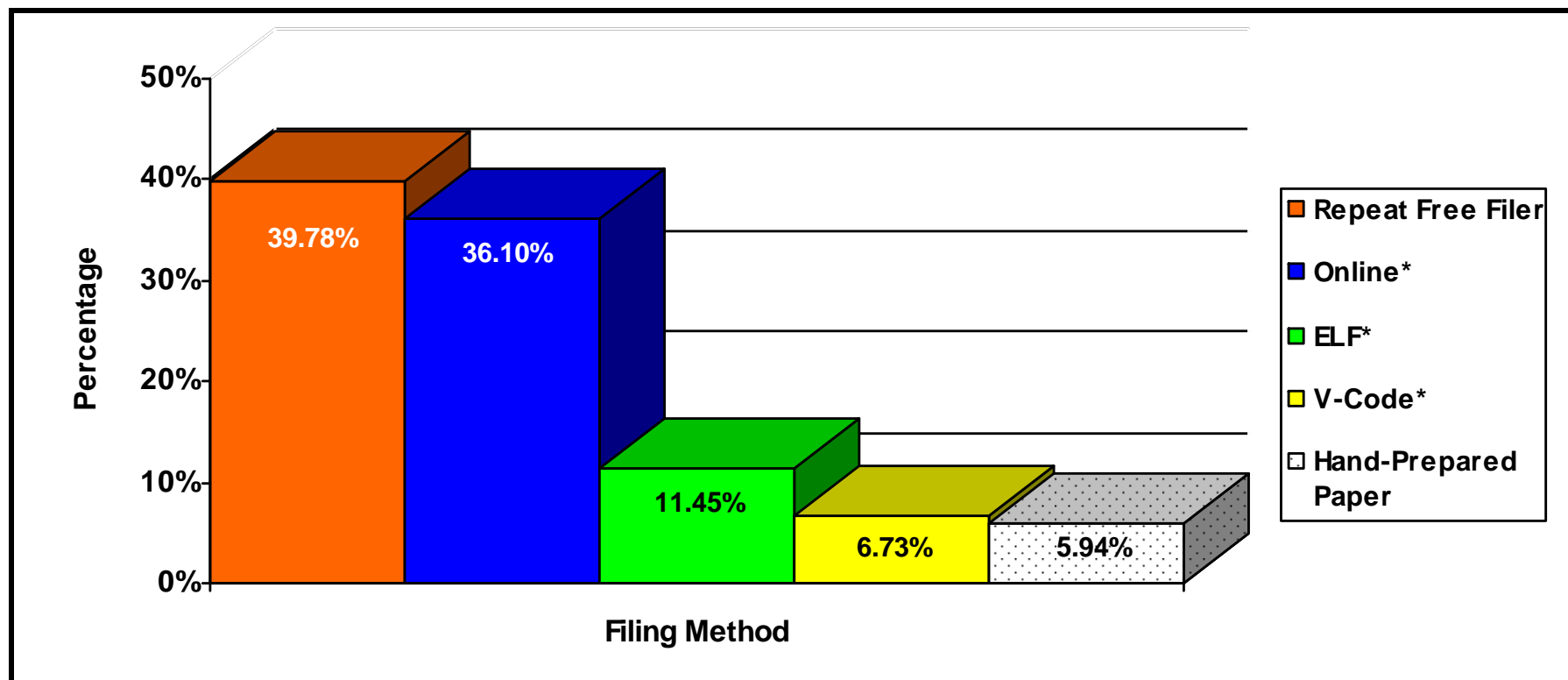


IRS Free File Program

- Free federal income tax preparation and electronic filing program for eligible taxpayers.
- For tax year (TY) 2006, qualified taxpayers had an adjusted gross income of \$52,000 or less.
- More than 91 million, or approximately 70 percent, of the TY 2006 taxpaying population qualified for the Free File Program.
- A partnership between the IRS and Free File Alliance, a group of industry leading private sector tax preparation companies.
- Available in English and Spanish.
- All tax returns are transmitted using secure technologies and taxpayers receive an e-mail from the tax preparation company letting them know if the IRS accepted their return.



For those Taxpayers who Free Filed in TY 2005 and were Eligible to Free File in TY 2006, what TY 2006 Filing Method did they Choose?



Source: ETA IMF Marketing Database Full Tax Year 2005 and 2006.

Notes: *V-Coded returns are mailed-in, computer generated tax returns.

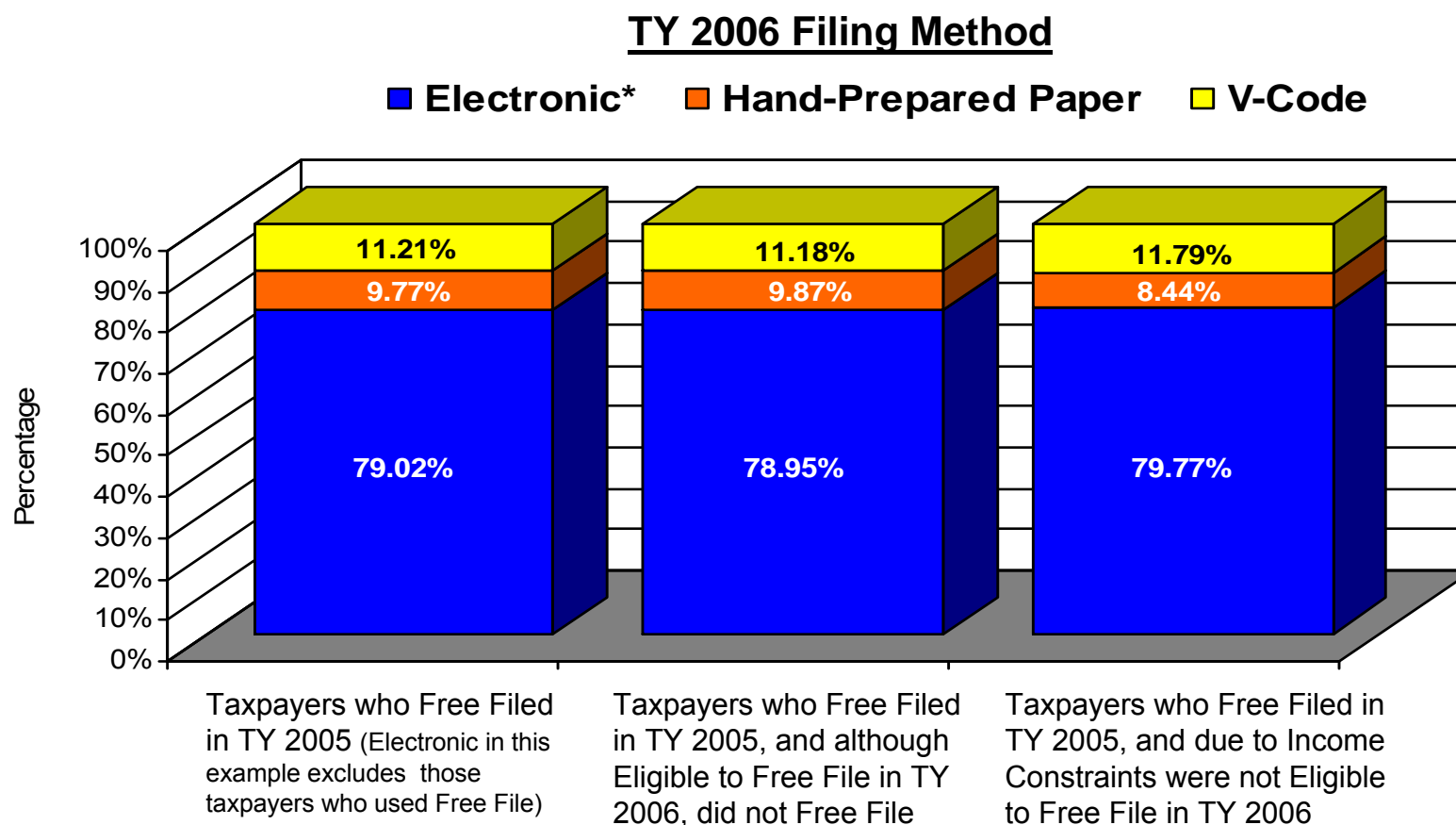
*ELF returns are electronically filed tax returns by a paid preparer.

*Online returns are self-prepared, online tax returns. In this example, online does not include Free Filed returns.



Internal Revenue Service

Free File Migration: What TY 2006 Filing Method did Non-Repeat Free Filers Choose?



Source: ETA IMF Marketing Database Full Tax Years 2005 and 2006.

Note: *Electronic is comprised of self-prepared, online returns and electronically filed returns by a paid preparer.



Internal Revenue Service

TY 2006 Filing Method of TY 2005 Free File Taxpayers by TY 2004 Filing Method

		<i>Filed a Paper Return in TY 2004</i>	<i>Filed a TeleFile Return in TY 2004</i>	<i>Filed an ELF Return in TY 2004</i>	<i>Filed an Online Return in TY 2004</i>
		<i>Free Filed in TY 2005</i>			
TY 2006 Filing Method	<i>Hand-Prepared, Paper</i>	57,947 (9.75%)	56,496 (9.43%)	12,097 (3.59%)	43,923 (3.14%)
	<i>V-Coded</i>	65,375 (11.00%)	40,085 (6.69%)	19,062 (5.66%)	70,545 (5.04%)
	<i>Electronic</i>	471,255 (79.26%)	502,245 (83.87%)	305,556 (90.75%)	1,283,857 (91.81%)

Source: ETA IMF Marketing Database Full Tax Years 2004, 2005, and 2006.

Free File Program as a Gateway to Electronic Filing: For each of the TY 2004 filing methods identified, TY 2005 Free Filers overwhelmingly continued to file electronically in TY 2006.



Internal Revenue Service

TY 2006 Filing Method of Entire Taxpayer Population

	<i>COUNT (*)</i>	<i>Percentage</i>
<i>Hand-Prepared, Paper</i>	17,865,323	13.29%
<i>V-Coded</i>	36,559,559	27.21%
<i>Electronic</i>	79,956,548	59.50%

Source: ETA IMF Marketing Database Full Tax Year 2006.

- Approximately 59.5 percent of the general taxpayer population filed an electronic tax return in TY 2006. Electronic returns are comprised of electronically filed returns by a paid preparer (ELF = 57,360,987) and self-prepared, electronic returns (Online = 22,595,561).
- In comparison, 87.04 percent of TY 2005 Free Filers continued to file electronically in TY 2006.



Case Study: IRS TeleFile Program

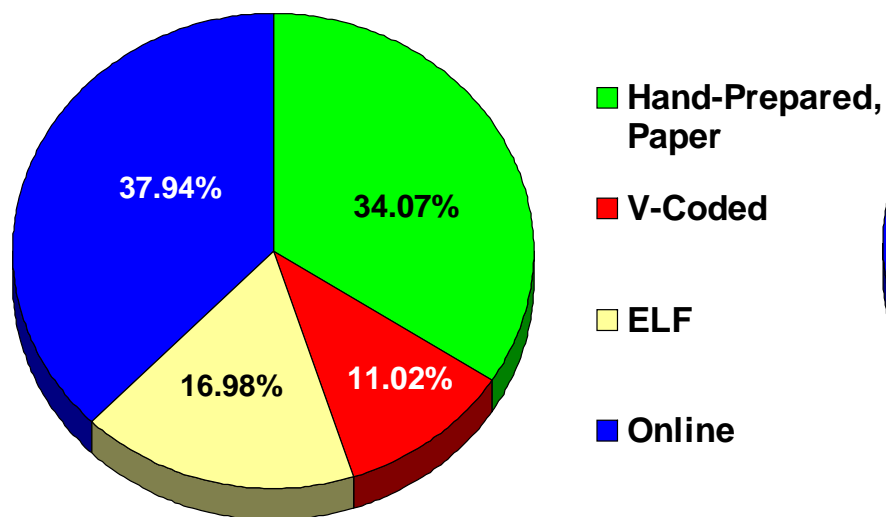
- Allowed taxpayers with simple individual or joint tax returns to file at no cost by using a telephone keypad.
- The TeleFile pilot program was launched on a limited basis in 1992 and later became available nationally to single Form 1040EZ filers in 1997.
- The program expanded to support the telephone filing of Form 941, Form 4868, and selected Forms 1040EZ and state individual tax returns.
- The IRS officially ended the TeleFile program on August 16, 2005 citing the following factors as contributing to the decision:
 - Increased costs of maintaining the system,
 - Declining use of federal TeleFile,
 - Declining use and discontinuance of state TeleFile programs,
 - Growth of other electronic filing alternatives, such as Free File.



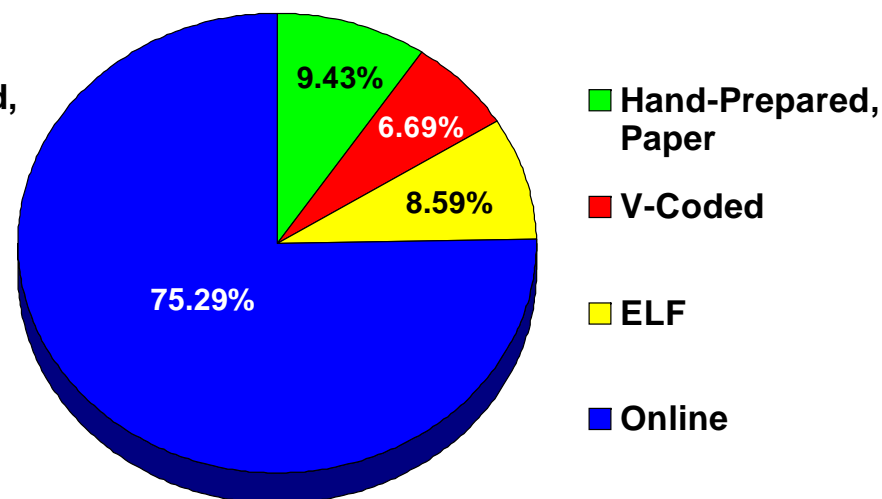
A Comparison of TY 2004 TeleFilers Post Filing Methods

- TY 2004 TeleFilers who Free Filed in TY 2005 overwhelmingly continued to file electronically in TY 2006 (83.88 percent for Online and ELF).
- Only 54.92 percent of the entire TY 2004 TeleFile population filed an electronic return in TY 2006.

**TY 2006 Filing Method
of TY 2004 TeleFilers**



**TY 2006 Filing Method
of TY 2004 TeleFilers who
Free Filed in TY 2005**



Source: ETA IMF Marketing Database Full Tax Years 2004, 2005, and 2006.



Internal Revenue Service

Tax Year 2006 Free File Participation Rates

TAXPAYER CLASSIFICATION	COUNT (*)	Percentage of All Filers
Free Filers	3,854,549	2.87%
Potential Free Filers	91,187,455	67.86%
All Filers	134,381,430	100.00%
Free File Eligible, Non-Participants	87,332,906	64.99%



Overall Free File Participation Rate* of 4.23 Percent

Source: ETA IMF Marketing Database Full Tax Year 2006.

Highest Participation Rates

State	Free File Participation Rate*
WA	5.99%
OH	5.92%
SD	5.80%
WI	5.75%
ME	5.59%

Source: ETA IMF Marketing Database Full Tax Year 2006.

Lowest Participation Rates

State	Free File Participation Rate*
NY	2.51%
NJ	2.65%
CA	2.82%
HI	3.29%
RI	3.43%

Source: ETA IMF Marketing Database Full Tax Year 2006.

Source: ETA IMF Marketing Database Full Tax Year 2006.

Note: *Free File Participation Rate equals Actual Free File Population Divided by Potential Free File Population.



Internal Revenue Service

Free Filers: Simple, Refund Returns

<i>Tax/Refund</i>	<i>Free Filers</i>	<i>Potential Free Filers</i>	<i>All Filers</i>	<i>Free File Eligible, Non-Participants</i>
Refund	3,653,001 (94.77%)	77,641,697 (85.15%)	107,655,577 (80.11%)	73,988,696 (84.72%)
Balance Due	173,751 (4.51%)	12,088,417 (13.26%)	25,192,384 (18.75%)	11,914,666 (13.64%)
Even	27,797 (0.72%)	1,457,341 (1.60%)	1,533,469 (1.14%)	1,429,544 (1.64%)
TOTAL	3,854,549	91,187,455	134,381,430	87,332,906

<i>Return Complexity</i>	<i>Free Filers</i>	<i>Potential Free Filers</i>	<i>All Filers</i>	<i>Free File Eligible, Non-Participants</i>
Simple	2,312,490 (59.99%)	36,237,870 (39.74%)	41,087,496 (30.58%)	33,925,380 (38.85%)
Intermediate	1,045,075 (27.11%)	30,033,112 (32.94%)	47,972,301 (35.70%)	28,988,037 (33.19%)
Complex	496,984 (12.89%)	24,916,473 (27.32%)	45,321,633 (33.73%)	24,419,489 (27.96%)
TOTAL	3,854,549	91,187,455	134,381,430	87,332,906

Source: ETA IMF Marketing Database Full Tax Year 2006.



Internal Revenue Service

Marketing Free File: Focus on Young Taxpayers

- Low Free File Participation Rate for taxpayers under 25-years-old $\approx 7\%$ (PR = Free Filers / Potential Free Filers)
- Taxpayers under 25-years-old are the largest percentage of Free File Eligible, Non-Participants $\approx 24\%$
- Conclusion: Taxpayers < 25-years-old have the greatest potential to increase Free File Program participation volume.

Age	Free Filers	Potential Free Filers	All Filers	Participation Rate
Under 25	1,576,831	22,115,850	22,479,489	7.13%

Source: ETA IMF Marketing Database Full Tax Year 2006.

Age	Free Filers	Potential Free Filers	All Filers	Free File Eligible, Non-Participants
Under 25	40.91%	24.25%	16.73%	23.52%
25 to 34	28.39%	21.09%	18.77%	20.76%
35 to 44	14.28%	16.14%	18.75%	16.23%
45 to 54	9.90%	14.32%	18.48%	14.52%
55 to 64	4.29%	10.28%	13.39%	10.54%
65 & Over	2.23%	13.92%	13.89%	14.43%
TOTAL	100.00%	100.00%	100.00%	100.00%

Source: ETA IMF Marketing Database Full Tax Year 2006.



Internal Revenue Service

Marketing Free File: Focus on Students

Students:

- Age 18 to 24
- Adjusted Gross Income \$0 to \$16,999
- Claimed No Earned Income Tax Credit (EITC)



<i>TY 2006 Filing Method</i>	<i>Students</i>	<i>All Filers</i>
Paper	5,604,655 (47.93%)	54,424,882 (40.50%)
ELF	3,587,282 (30.68%)	57,360,987 (42.69%)
Online	2,501,380 (21.39%)	22,595,561 (16.81%)
<i>TOTAL</i>	11,693,317	134,381,430

Source: ETA IMF Marketing Database Full Tax Year 2006.



Internal Revenue Service

Marketing Free File to Students Simple Returns with Refunds

<i>Tax/Refund</i>	<i>Students</i>	<i>All Filers</i>
Refund	10,433,122 (89.22%)	107,655,577 (80.11%)
Balance Due	1,037,128 (8.87%)	25,192,384 (18.75%)
Even	223,067 (1.91%)	1,533,469 (1.14%)
<i>TOTAL</i>	11,693,317	134,381,430

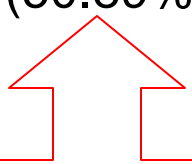
<i>Return Complexity</i>	<i>Students</i>	<i>All Filers</i>
Simple	9,217,128 (78.82%)	41,087,496 (30.58%)
Intermediate	1,296,400 (11.09%)	47,972,301 (35.70%)
Complex	1,179,789 (10.09%)	45,321,633 (33.73%)
<i>TOTAL</i>	11,693,317	134,381,430

Source: ETA IMF Marketing Database Full Tax Year 2006.



Internal Revenue Service

A Potential Free File Target Market: More than 4.3 Million Young, Self-Prepared, V-Coded, Free File Eligible Taxpayers

AGE	Self-Prepared, V-Coded, Potential Free Filers	Percentage	
Under 25	2,793,296	33.03%	} 4,303,710 (50.89%)
25 to 34	1,510,414	17.86%	
35 to 44	1,087,976	12.87%	
45 to 54	1,069,808	12.65%	
55 to 64	825,933	9.77%	
65 and Older	1,169,196	13.83%	
TOTAL	8,456,623	100.00%	

Over half of these self-prepared, V-Coded, Free File eligible taxpayers are age 34 or younger.

Source: ETA IMF Marketing Database Full Tax Year 2006.



Internal Revenue Service

Self-Prepared, V-Coded, Free File Eligible Taxpayers

Tax/Refund	Self-Prepared, V-Coded, Potential Free Filers	Free File Eligible, Non-Participants
Refund	6,561,176 (77.59%)	73,988,696 (84.72%)
Balance Due	1,664,627 (18.32%)	11,914,666 (13.64%)
Even	230,820 (2.73%)	1,429,544 (1.64%)
<i>TOTAL</i>	8,456,623	87,332,906

Return Complexity	Self-Prepared, V-Coded, Potential Free Filers	Free File Eligible, Non-Participants
Simple	3,979,805 (47.06%)	33,925,380 (38.85%)
Intermediate	2,333,189 (27.59%)	28,988,037 (33.19%)
Complex	2,143,629 (25.35%)	24,419,489 (27.96%)
<i>TOTAL</i>	8,456,623	87,332,906

Source: ETA IMF Marketing Database Full Tax Year 2006.



Internal Revenue Service

Summary/Conclusions

Free File as a Gateway to Continued Future Electronic Filing

Free File migration data supports the hypothesis that past participation in the Free File Program acts as a gateway to continued future electronic filing.

- Data migration analysis reveals that approximately **79.8 percent** of individuals who Free Filed in TY 2005 and although no longer eligible to Free File in TY 2006 due to the income constraints of the Free File Program continued to file electronically.

Young Taxpayers/Students and Young, Self-Prepared, V-Coded, Potential Free Filers

A majority of the taxpayers in these two market segments file simple returns with refunds and tend to be computer literate.

- V-Coders electronically prepare their own tax returns on a computer.
- Taxpayers under age 30 report a strong preference for using the internet to find tax forms/publications and get tax return preparation guidance.*

Potential for high return on marketing dollars.

- Young taxpayers are expected to file a tax return for many more years.
- 11.69 million students and 8.46 million self-prepared, V-Coded potential Free Filers in TY 2006.

Source: *Taxpayer Preference for IRS Service, W&I Strategic Forecasting & Analysis Group and The 2006 Taxpayer Assistance Blueprint, Phase 1, April 24, 2006.



Internal Revenue Service

ETA IMF Marketing Database Tax Year 2005

Definitions

Free Filer (TY 2005): a taxpayer who participated in the IRS Free File Program, had an adjusted gross income of \$50,000 or less, and filed their return online. For TY 2006, adjusted gross income increased to \$52,000 and taxpayer is also no longer allowed to receive a refund anticipation loan (RAL) or refund anticipation check (RAC).

Potential Free Filer (TY 2005): encompasses the entire universe of taxpayers who filed a return with an adjusted gross income of \$50,000 or less (included in this universe are taxpayers who participated in the Free File Program). For TY 2006, adjusted gross income increased to \$52,000.

Free File Eligible (TY 2005): taxpayers with an adjusted gross income of \$50,000 or less (i.e., Potential Free Filer). For TY 2006, adjusted gross income increased to \$52,000.

All Filers: captures all taxpayers who filed a return in a particular tax year.

Free File Eligible, Non-Participants: taxpayers who qualified for, but did not participate in the Free File Program.

Free File Participation Rate: equals the actual Free File population divided by the Potential Free File population.



ETA IMF Marketing Database Tax Year 2005

Definitions Continued . . .

Free File Eligibility Rate: equals the number of Potential Free Filers in a state divided by total filer population of the state.

V-Coded: computer generated return filed as paper.

Self-Prepared: self or VITA prepared tax return.

Simple Return: Form 1040, 1040A, or 1040EZ, without any schedules.

Intermediate Return: Form 1040A with Schedules or 1040 with Schedules A, B, D, Additional Child Tax Credit, Educational Credits, Child Care Credit, Credit for the Elderly, or Earned Income Credits.

Complex Return: Form 1040 with Schedules C, E, F, or other Schedules and all other specific Forms 1040 (i.e., 1040PR, etc.).

Online Return: returns prepared online by a taxpayer (self-prepared).

ELF Return: electronically filed returns by a paid preparer.

Electronic Returns: the sum of online returns and ELF returns.

